CALIFORNIA STUDENT AID COMMISSION
LOAN ADVISORY COUNCIL
TELECONFERENCE MEETING

Access Group
5500 Brandywine Parkway
Wilmington, DE

Cal Poly Pomona
ASI Bronco Student Center - Bldg. 35
3801 W. Temple Blvd.
Pomona, CA

Dominican University of California
Financial Aid Office
79 Acacia Ave., Rm. 104
San Rafael, CA

Glendale Community College
Financial Aid Office
San Fernando 110C
1500 N. Verdugo Rd.
Glendale, CA

John F. Kennedy University
Financial Aid Office
100 Ellinwood Way
Pleasant Hill, CA

The Student Loan Corporation, Citibank, N.A.
750 Washington Blvd.
Stamford, CT

University of California, San Diego
Financial Aid Office
Bldg. 201 University Center
9500 Gilman Drive
La Jolla, CA

University of California, San Francisco
Millberry Union, Rm. 201 West
500 Parnassus Ave.
San Francisco, CA

University of California Student Association
385 Grand Ave., Ste. 302
Oakland, CA

United States Department of Education
50 United Nations Plaza
San Francisco, CA

Wells Fargo Education Financial Services
301 East 58th St., North
Sioux Falls, SD

Tuesday, April 11, 2006

2:30 p.m.
(meeting time is approximate)

	AGENDA ITEMS	TAB
	Call to Order and Roll Call	
	Public Comment	
Action/Information	Election of Chair and Vice Chair	**1**
Action/Information	Approval of Minutes from the January 30, 2004 and February 9, 2006 Meetings	**2**
Action/Information	Discussion of the Legislative Analyst's Office Recommendation Regarding Restructuring How the State Administers Grant and Loan Financial Aid Programs	**3**

Note: Items designated for information are appropriate for Committee action if the Committee wishes to take action. Any agenda item acted upon at this Committee meeting may be brought to the Commission at its next regularly scheduled meeting.

Adjournment at approximately 4:00 p.m.

LOAN ADVISORY COUNCIL MEMBERS

Ben Chiu
U.S. Education Department

Vince DeAnda
University of California Institution
University of California, San Diego

Kenneth Evans, Jr.
California State University Student
California State University Associated Students

Robert Haushalter
Participating Lending Community
Access Group

Patricia Hurley
California Community Colleges
Glendale Community College

Greg Jaeger
Participating Lending Community
Wells Fargo Education Financial Services

Brian Jones
Participating Lending Community
College Loan Corporation

Anu Joshi
University of California Student
University of California Student Association

Dean Kulju
California State University Institution
California State University, Long Beach

Dolores Niccolai
California Lenders for Education (CLFE)
ACS Education Services

Kurt Schneiber
Participating Lending Community
The Student Loan Corporation, Citibank, N.A.

Carrie Steere-Salazar
California Association of Student Financial Aid Administrators (CASFAA)
University of California, San Francisco

Audrey Tanner
Private Post-secondary Education (Non-Profit) Institution
Dominican University of California

Ruth Tesfai
Private Post-secondary Education (Non-Profit) Student
St. Mary's College of California

<u>Vacancies</u>

California Community Colleges Student

Private Post-secondary Education (For-Profit) Institution

Private Post-secondary Education (For-Profit) Student

Participating Secondary Market

Janet McDuffie
Commission Staff Liaison
Chief, Management Services Division
Acting Chief, Federal Policy & Programs

Therese Bickler
EDFUND Staff Liaison
Vice President, Loan Operations

MISSION STATEMENT

"The mission of the Loan Advisory Council is to recommend to the Commission policies which will maximize the availability, delivery and servicing of high quality, effective student loans; encourage responsible borrower behavior and discourage unnecessary borrowing; expand services to all customers of the Student Aid Commission and maximize default prevention."

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INFORMATION/ACTION ITEM

LOAN ADVISORY COUNCIL

Election of Chair and Vice Chair

The California Education Code requires the Loan Advisory Council to annually elect a Chair and Vice Chair. In 2003, Bill Beckmann and Carrie Steere-Salazar were elected Chair and Vice Chair, respectively. Upon Mr. Beckmann's departure from the Council, Ms. Steere-Salazar assumed the role of Acting Chair. Member Steere-Salazar's previous term expired in 2004, and although she was re-appointed for a new term and is currently serving on the Council, a new election has not taken place and the offices of Chair and Vice Chair are currently vacant.

The *Uniform Policies for Advisory Bodies*, Chapter 3, Section 7.4 indicates that the terms shall be for a period of one year and the Chair and Vice Chair shall be in office no more than two consecutive terms. In the past, the Vice Chair was typically nominated to serve as the Chair, and members nominated one other person as Vice Chair. If both candidates agreed, members would vote to approve the nominations.

Enclosed under Tab 1 is a description of the duties for which the Chair is responsible. In the absence of the Chair the Vice Chair assumes the role.

At the Council's February 9, 2006 meeting, a consensus was reached to postpone election of officers until the subsequent meeting to allow members to determine their interest in the position(s).

Recommended Action:

Nominate and vote on candidates for the positions of Chair and Vice Chair of the Loan Advisory Council for a one-year term.

Responsible Staff: Janet McDuffie, Chief, Management Services Division and Acting Chief, Federal Policy & Programs Division

LOAN ADVISORY COUNCIL

California Education Code Section 69769.7 requires the Loan Advisory Council to annually elect a Chair and Vice Chair from its membership. This code states that representatives who serve on, or are employed or retained by, the Commission, and the nonvoting representative appointed by the U.S. Department of Education, are ineligible to these positions.

Duties of the Chair

As mandated in statute, the Chair of the Council shall have the authority, in consultation with the Chair of the Commission, to convene meetings of the Council. The Chair shall also direct each Council meeting and shall regularly present oral and written reports to the Commission regarding the advice of the Council. The Vice Chair shall assume these responsibilities in the Chair's absence.

The *Uniform Policies for Advisory Bodies* requires the Chair to perform the following duties:

- Actively participate in all Council matters.
- Ensure that the Council operates in a manner consistent with its own rules and any other applicable rules or requirements.
- Preside over Council meetings and facilitate the process whereby the Council accomplishes its business.
- Foster cooperation and teamwork among Council members, including expeditious and frequent communication with all members.
- Publicly represent the Council on policies made and actions take by the Council and other matters affecting the Council.
- Appoint the chair and members of ad hoc and special bodies or work groups.
- Set the agenda items for scheduled Council meetings.
- Follow up on members with attendance problems, per the established attendance policies.
- Make Council reports and presentations to the Commission, including the presentation of the Council's annual objectives and accomplishments.

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INFORMATION/ACTION ITEM

LOAN ADVISORY COUNCIL

Approval of Minutes of the January 30, 2004 and February 9, 2006 Meetings

Only one of the current members of the Council was present during the January 30, 2004 meeting. Current members are allowed to vote on these minutes but the Commission recognizes that those who were not present may wish to abstain. In the event that the current members who were not present do abstain and a motion to approve the minutes does not pass by majority vote, then an alternative method for approval of minutes is available as follows:

Once a Chair is selected, the Chair may choose to follow Robert's Rules of Order, Article X, which would allow the Chair to appoint a special committee consisting of the sole existing member present at the meeting to correct and approve the minutes.

Recommended Action: Approve the minutes of the January 30, 2004 and February 9, 2006 meetings.

Responsible Staff: Janet McDuffie, Chief, Management Services Division and Acting Chief, Federal Policy & Programs Division

CALIFORNIA STUDENT AID COMMISSION
LOAN ADVISORY COUNCIL

MINUTES
January 30, 2004

The Loan Advisory Council (Council) met via teleconference at 3:30 p.m. on Friday, January 30, 2004, at Saint Mary's College of California, Office of Financial Aid, 1928 Saint Mary's Road, Moraga, California.

Council Members Present:

Carrie Steere-Salazar, Acting Chair – via phone
Christopher Chapman – via phone
Paul Dockry – via phone
Linda Elrod – via phone
Debbe Johnson – via phone
Billie Jones
John Muskavitch – via phone
Judith Perry – via phone
Melanie Saracco – via phone

Council Members Absent:

Rainie Brazil
Karen Cai
Martin Daniels
Robert Johnson
Albert Mendez
Paul Rehnberg

AGENDA ITEM 1 – APPROVAL OF JULY 16, 2003 MEETING MINUTES

On **MOTION** by Member Muskavitch, **SECONDED** and **CARRIED**, the minutes of the July 16, 2003 meeting were **APPROVED**.

AGENDA ITEM 2 – INSURANCE PREMIUM FEE WAIVER

Dana Callihan, Vice President, EDFUND External Relations, explained that the Commission always makes a one-year decision with respect to the insurance premium fee and the recommended action from Commission/EDFUND staff is to waive the fee through September 30, 2005. He clarified that the Pennsylvania Higher Education Assistance Agency (PHEAA) has publicized that they will waive the fee until July 1, 2005, and then begin charging 1%.

Janet McDuffie, Chief, CSAC Management Services, presented the CSAC/EDFUND Federal Student Loan Reserve Fund Forecast for 2002-03 through 2004-05. She indicated that the revenue source for the Federal Fund has been the insurance premium. She explained that a minimum reserve level must be maintained in the Federal Fund, which has been depleted over time because the insurance premium fee has been waived. CSAC draws a subsidy from the Student Loan Operating Fund. Since 1996, CSAC has been able to waive the fee and can afford to continue doing so for the 2004-05 fiscal year.

The Council expressed concern that they were being asked to make a recommendation to the Commission without all of the financial data. They were assured that the data reflects numbers that are sufficient enough to meet and sustain the current operating environment through the next federal fiscal year.

A question arose as to potential revenues if the 1% guarantee fee were charged for the coming year. Therese Bickler, Vice President of EDFUND Loan Operations, reported CSAC/EDFUND did 4.4 billion in student loans which would equate to $44 million in insurance premium fees. As loan volume is expected to continue to grow, the revenue source would probably be in excess of $44 million. She clarified that if the fee is reinstated, CSAC/EDFUND could lose loan volume and the revenue would be less; likewise, if the fee is waived, loan volume could increase and the potential revenue could be $44 million or more.

On **MOTION** by Member Dockry, **SECONDED** and **CARRIED**, the recommendation to the Commission to extend the insurance premium fee waiver through September 30, 2005 was **APPROVED**.

PUBLIC COMMENT

No public comments were presented.

There being no further business, the meeting of the Loan Advisory Council was adjourned at approximately 3:50 p.m.

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Chair, Loan Advisory Council

CALIFORNIA STUDENT AID COMMISSION
LOAN ADVISORY COUNCIL

MINUTES
February 9, 2006

The Loan Advisory Council (Council) met at 10:30 a.m. on Thursday, February 9, 2006, at the EDFUND Boardroom, 3300 Zinfandel Drive, Rancho Cordova, California.

Council Members Present:

Ben Chiu
Vince DeAnda
Robert Haushalter
Patricia Hurley
Brian Jones
Dean Kulju
Dolores Niccolai
Carrie Steere-Salazar

Council Members Absent:

Kenny Evans, Jr.
Greg Jaeger
Anu Joshi
Kurt Schneiber
Audrey Tanner

Janet McDuffie, Chief of Management Services, Acting Chief of Federal Policy & Programs and Loan Advisory Council Liaison opened the meeting and each Council member provided a brief introduction. Ms. McDuffie explained that two members notified Commission staff this morning that they were unable to attend the meeting; therefore, the Council would not have a quorum and could not vote.

AGENDA ITEM 1 – ADMINISTRATIVE ISSUES REGARDING THE COMMISSION'S UNIFORM POLICIES

Ms. McDuffie reviewed the Commission's Uniform Policies with Council members and highlighted several key items for new members including attendance, quorum, conflict of interest issues, expectations of advisory body members, the Bagley-Keene Open Meeting Act and the Commission's travel policy.

AGENDA ITEM 2 – DISCUSSION OF ROLE AND FUNCTION OF THE LOAN ADVISORY COUNCIL

The Council discussed its role and function and it was noted that there had been a disconnect between the Commission and the Council over the last two years and the group should meet more frequently in light of the current issues. There was concern that the committee was not being taken seriously. The group was informed that Commission staff is working to fill vacancies and keep this body active on the important topics and in communication with the Commission.

AGENDA ITEM 3 – ELECTION OF CHAIR AND VICE CHAIR

Due to a lack of quorum, the Council postponed the election of its chair and vice chair.

AGENDA ITEM 4 – APPROVAL OF JANUARY 30, 2004 MEETING MINUTES

Due to a lack of quorum, the Council postponed the approval of the minutes.

AGENDA ITEM 5 – ROUNDTABLE DISCUSSION ON THE FUTURE ROLE OF THE LOAN ADVISORY COUNCIL

A. DEFICIT REDUCTION ACT AND LOAN POLICY IMPLICATIONS
B. CSAC/EDFUND RELATIONSHIP

The Council participated in a roundtable discussion of the committee's future role. Executive Director Michel and EDFUND President Kipp shared their perspectives and both emphasized the importance of the Council's input on relative issues within the student loan industry. It was suggested that the Council identify the two or three most important issues that would be the most meaningful to the Commission, such as the various segmental perspectives on the anticipated recommendation from the Legislative Analyst's Office (LAO) on structural options for California's Federal Family Education Loan (FFEL) Program.

The committee reviewed a summary of the major provisions of the Deficit Reduction Act and the following represents the types of issues that are of the most concern:

- Impact of the California High School Exit Examination (CAHSEE) issue on grants and loans
- Manageable debt and average indebtedness of graduated students
- The need for California to compete with out-of-state schools for students
- Impact of merit-based aid on loans
- 1% default fee
- Schools-as-lenders
- Consolidation lender practices
- PLUS loans

The Council reviewed the eighth draft of the Roles and Responsibilities and the LAO's report on structural options for the FFEL Program. Some comments by members include:

- EDFUND should have the flexibility to operate like its competitors in the industry.
- There is inherent value to EDFUND's connection with the Commission and there is some loyalty to EDFUND due to that State connection.
- Any perceived instability with regard to the relationship between the Commission and EDFUND is a concern.
- A school's decision to partner with CSAC/EDFUND is based ultimately on what is in the best interest of the students.

AGENDA ITEM 6 – FUTURE TOPICS

The next meeting's topic will include a discussion of the LAO's recommendation regarding the structural options for California's FFEL Program. The meeting will be scheduled in early April 2006 in order to provide the Council's feedback to the Commission at its April 20-21, 2006 meeting.

There being no further business, the meeting of the Loan Advisory Council was adjourned at 3:05 p.m.

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Chair, Loan Advisory Council

INFORMATION/ACTION ITEM

LOAN ADVISORY COUNCIL

Discussion of the Legislative Analyst's Office Recommendation Regarding Restructuring How the State Administers Grant and Loan Financial Aid Programs

An informational joint hearing was held on March 8, 2006 by the Senate Education Committee, the Senate Budget Subcommittee #1 on Education and the Assembly Higher Education Committee to discuss the topic of "Examining the Governance of EdFund and the California Student Aid Commission: Options for the Federal Family Education Loan Program." Commission staff has provided a summary of the March 8, 2006 discussion for your review. (Tab 3A)

At its February 9, 2006 meeting, the Loan Advisory Council discussed the Legislative Analyst's Office (LAO) January 2006 report on "California's Options for Administering the Federal Family Education Loan (FFEL) Program."

On February 24th, the LAO released a detailed analysis of the 2006-07 Budget Bill (based on the Governor's Budget), which included LAO's recommendation that "the Legislature enact legislation that would restructure how the state administers grant and loan programs. Specifically, [LAO] recommend[s] the Legislature authorize a single agency, with a single board and Executive Director, to administer both state grant and federal loan programs. [LAO] recommend[s] the agency be structured as a nonprofit public benefit corporation but subject to stronger accountability requirements." This portion of the budget analysis is enclosed for your review. (Tab 3B)

Written testimony submitted to the Joint Assembly and Senate Education Committees is also available. (Tab 3C)

Recommended Action: This is an informational item. No action is recommended.

Responsible Staff: Janet McDuffie, Chief, Management Services Division and Acting Chief, Federal Policy & Programs Division

Summary of the Joint Hearing of the Senate and Assembly Education Committees and the Senate Budget and Fiscal Review Subcommittee #1

An informational joint hearing was held on March 8, 2006 by the Senate and Assembly Education Committees and the Senate Budget and Fiscal Review Subcommittee #1 to discuss the topic of "Examining the Governance of EDFUND and the California Student Aid Commission: Options for the Federal Family Education Loan Program."

Below is a comprehensive list of the presenters.

Jennifer Kuhn, Principal Fiscal and Policy Analyst, Legislative Analyst Office

Sam Kipp, President, EDFUND

James Sandoval, Chair, California Student Aid Commission

Greg Gollihur, Senior Policy Analyst, California Postsecondary Education Commission

Veronica Villalobos, Vice President for Public Affairs, Association of Independent Colleges and Universities

Catherine Thomas, Associate Dean/Director of Financial Aid, University of Southern California

Craig Yamamoto, Past President, California Community College Student Financial Aid Administrators Association

David Nelson, Student, California Community College Statewide Student Senate

Jeannie Biniek, Board Member, University of California Student Association

Alex Alanis, Legislative Advocate, California Bankers Association

Todd Eicher, Executive Director, Nelnet

Amy Hines, Labor Relations Representative, Service Employees International Union Local 1000

Mike Rosky, President, District Labor Council

The following is a synopsis of the presentations:

Jennifer Kuhn, Principal Fiscal and Policy Analyst, Legislative Analyst Office (LAO)

The LAO presented its opinion of organizational options for administering the Federal Family Education Loan (FFEL) Program. LAO suggested that the Legislature can select one of five basic organizational models for administering the FFEL Program. Under a single-agency structure, the Legislature could: (1) entrust a state agency with administering both grand and loan programs or (2) establish a nonprofit public benefit corporation to perform them. Under a two-agency structure, the Legislature could (3) retain the existing two-agency arrangement, (4) modify the existing two-agency arrangement, or (5) rely on an independent guaranty agency to administer the FFEL Program.

LAO stated that given the unique intricacies of student financial aid, they recommend the Legislature authorize a single agency, with a single board and Executive Director, to administer both state and grant and federal loan programs.

- With a single board and Executive Director, tension is less likely among organizational leadership.
- With a single agency, confusion about roles and responsibilities is likely to be more easily and quickly resolved.
- As a nonprofit public benefit corporation:
  - The agency could reward all employees for providing high-quality service to students.
  - The agency would retain flexibility to respond to externally driven changes in loan programs and loan competitors.
- Greater operational autonomy should be coupled with greater accountability and reporting requirements.
- The new structure could accommodate broader reform.

Sam Kipp, President, EDFUND

President Kipp indicated that EDFUND has met, and exceeded, the mandate set by the California Legislature and the Student Aid Commission when it was created such as earning more than $995 million in revenue, tripling the annual loan volume from $2.4 billion to $7.8 billion, and saving borrowers more than $300 million in fees. President Kipp also described the challenges EDFUND faces. For example, under new federal laws, it is compelled to charge borrowers a 1 percent loan fee for the first time since 1996 and the state is still using loan program revenues to pay for $22 million in Commission administrative costs and support to the Cal-SOAP program. He noted that the relationship between the Student Aid Commission and EDFUND has generally worked well and has delivered real benefits to the citizens of California, and to students and educational institutions throughout the nation. President Kipp stated that EDFUND has not adopted a position on the LAO's recommendation to operate both organizations through a single nonprofit, public benefit corporation, but identified the following key issues:

1. It will be critical to sustain and not disrupt or diminish EDFUND's capacity to continue to provide essential loan funds and premier services to borrowers and institutions.
2. Recognize that a nonprofit corporation that provides financial aid services such as technology, accounting, administrative, and customer service is different from one that oversees policy.
3. In weighing options, reducing costs and complexity without compromising service will be important considerations.
4. No student loan guarantee services organization can remain competitive in California or nationally without having vital operating flexibility and an adaptive and responsive structure that enables it to provide high quality services.
5. Accountability mechanisms are certainly appropriate but they should seek to avoid adding a whole new layer of state agency rules and requirements that do not apply to our competitors.

James Sandoval, Chair, California Student Aid Commission (Commission)

Commissioner Sandoval provided background information regarding the Commission and indicated that the Commission agrees with LAO that structural changes for the Commission and EDFUND are needed. Commissioner Sandoval stated that the Commission has not taken a position on the LAO's recommendation to create a single non-profit agency to administer the grant and loan programs; however, the Commission concurs that the Legislature should review the mission, structure and governance of both the Commission and EDFUND so that both organizations are positioned to efficiently and effectively deliver the state's financial aid programs and the FFEL Program. Commissioner Sandoval indicated that in considering any options to restructure the Commission and EDFUND, it is important to note that legal, operational, and policy issues will need to be examined, including, but not limited to, the following:

- How can the transition to a new governance and organizational structure be managed so as to not disrupt the delivery of grants and loans, not diminish services to students and institutions, and not compromise EDFUND's competitive position?
- Who should have responsibility for policy with respect to the Cal Grant programs and with respect to the federal student loan programs?
- How should the Board of a single agency, which serves students in California and throughout the nation, be structured? What should be its composition?
- What are the most appropriate mechanisms to preserve the administrative flexibility and competitiveness of the non-profit public benefit organization while ensuring accountability?
- How can the awarding, delivery, and administration of Cal Grants be best structured to insure quality service to students and institutions, efficiency, program effectiveness, and accountability?
- How could current state employees be integrated into the workforce of a non-profit, public benefit corporation while protecting their jobs, benefits, and retirement rights?
- Are there efficiencies that could be achieved through the creation of a single non-profit public benefit corporation? If so, what are they and how much could potentially be saved?

Greg Gollihur, Senior Policy Analyst, California Postsecondary Education Commission (CPEC)

Mr. Gollihur indicated that the LAO's recommendation to create a single not-for-profit entity responsible for the delivery of the Cal Grant programs as well as the FFEL Program is solid, sensible, and doable, indicating that the existing arrangement is unworkable and it is not in the interest of students, schools, or the organizations themselves to allow it to continue. Mr. Gollihur stated that there are a number of real advantages for students, schools and the State from the proposed LAO model. For example, consolidation of duplicative and overlapping functions and performance based delivery systems.

Additionally, Mr. Gollihur pointed out a number of issues that should be examined when considering LAO's recommended approach, as follows:

- Clearly define the role of the Student Loan Operating Fund.
- Make the guaranty function the responsibility of the not-for-profit entity.
- Recognize the importance of business diversification, which would benefit schools, students and families, and enhance the State's interest in maintaining a viable business entity, capable of supporting other activities such as outreach and the administration of Cal Grant programs.
- Reengineer the grant programs along a decentralized model.
- Provide for greater community input.
- Consider separating out the policy development functions from a not-for-profit operational entity.

Veronica Villalobos, Vice President for Public Affairs, Association of Independent Colleges and Universities (AICCU)

Ms. Villalobos indicated that 70 of the 76 members of the AICCU are clients of EDFUND. Ms. Villalobos stressed that above all, service to students should be the primary goal.

Catherine Thomas, Associate Dean/Director of Financial Aid, University of Southern California (USC)

Ms. Thomas indicated that USC provides FFEL Program loans to their students and families totaling over $220 million for 2004-05 year and loans guaranteed through the Commission/EDFUND for about $187 million, for 85% of their total volume and they expect this to increase for next year. USC values EDFUND's commitment to services and USC feels a commitment to support well run programs in California that serve the public interest. However, the tensions of the last year between the Commission and EDFUND and the uncertainty in governance and structure has given USC pause. What USC and the rest of the independent sector hope the Legislature will do over the next several months is to take the necessary time to examine any and all alternatives that would reinforce the core values and services that have become the EDFUND hallmarks. The organizational structure must be one that will serve the needs of students and institutions and yet prevent the dangers and vulnerabilities presented by a full state agency or by the mixed model. USC is anxious to see serious attention paid to the grant side of the Commission as well as the loan side.

Craig Yamamoto, Past President, California Community College Student Financial Aid Administrators Association (CCCSFAAA)

Mr. Yamamoto indicated that CCCSFAAA endorses the concept of the LAO recommendation to enact legislation to restructure the Commission and EDFUND into a single agency. CCCSFAAA agrees that as a nonprofit public benefit corporation it will be subject to stronger accountability requirements and improve issues. CCCSFAAA reserves its total endorsement of the plan until more information is available concerning the procedures for selecting the governing board and executive director. CCCSFAAA strongly recommends involving representatives from all stakeholders and constituencies in the planning and decision making process regarding any reorganization.

David Nelson, Student, California Community College Statewide Student Senate (CCCSSS)

Mr. Nelson indicated that he represents 2.5 million students who are the prime recipients and benefactors of financial aid. Mr. Nelson stated that he is not going to advocate for a certain position as to how or whether the Legislature should re-organize, but said that the Legislature should be mindful that California is still a leader in the nation.

Alex Alanis, Legislative Advocate, California Bankers Association (CBA)

Ms. Alanis indicated that the CBA has concerns about structural issues. CBA is pleased that the Commission and EDFUND structure is being discussed and is interested in hearing more about LAO's recommendation. CBA does not want to see a guaranty agency that is a private company that provides all services because this would result in less competition and inferior products and services.

Todd Eicher, Executive Director, Nelnet

Mr. Eicher highlighted Nelnet and its accomplishments. Mr. Eicher encouraged the committees, as they consider options for California, to consider incorporating the following characteristics of successful guaranty agencies nationally:

- Student-Focused Culture
- Adaptability
- Innovative Products and Services
- Efficient, State-of-the-Art Systems
- Financial Strength and Predictability of Resources
- Organizational Flexibility

He also encouraged the committees to examine the steps taken by others to create a sustainable business strategy, including the following best practice which may offer a roadmap for California:

- Diversification of product and service offerings to enhance the student experience and ensure sustained competitiveness through multiple revenue sources.
- Partnerships or strategic alliances with other companies to achieve diversification's results without heavy capital investment.
- Joint system development or system timesharing with other guarantors to achieve economies of scale and access to state-of-the-art systems at an affordable cost.
- Creative and constructive ways to both increase the level of service provided to students and schools, and lower operating costs. An example of this for California would be

streamlining systems such as combining the delivery of both loans and grants through one system or delivery mechanism.

- Outsourcing of some or all operational areas to partners who can provide these services at a lower cost and higher quality due to the efficiencies of economies of scale. Pricing can be done on either a fee-for-service or revenue-sharing basis.

Mr. Eicher stated that considering the future of the Commission and EDFUND, and what is best fro the State of California and its students, it should be clear that the single worst option before the Legislature is to do nothing.

Amy Hines, Labor Relations Representative, Service Employees International Union Local 1000

Ms. Hines represents the state employees at the Commission and EDFUND. She indicated that SEIU Local 1000 is opposed to privatizing and does not believe that the responsibility should lie with a non state agency. She pointed out that LAO reported only 2 out of 35 state agencies had the non-profit scenario and the committees should examine why that is.

Ms. Hines explained that where the LAO report indicates governance problems, SEIU Local 1000 sees accountability to the state and tax payers. She disagrees that the civil service system gets in the way of providing incentives stating that the Lottery has an incentive system. Ms. Hines disagrees with LAO that a state agency cannot be customer service oriented.

Mike Rosky, President, District Labor Council

Mr. Rosky stated that the civil service system is designed to protect the interest of the people form private interest and political parties. The challenge that the Legislature faces is meeting the needs of the people of California and that cannot be accomplished with a privatization, it opens up the system to corruption and inefficiencies and the only oversight is a final report. Mr. Rosky indicated that the duty of the Legislature is to provide the funds to allow agencies to do their jobs and serve the people of California.

The hearing adjourned at 11:45 A.M.

the program then provides up to an additional $4,000 in loan forgiveness if the individual teaches science, math, or special education and up to another $4,000 in loan forgiveness if the individual teaches in one of these high-priority shortage areas *and* serves in a school ranked in the bottom two deciles of the Academic Performance Index. In short, the program encourages individuals to become math and science teachers by offering them significant additional benefits.

Rather Than Adding Unneeded Complications, Simply Retain Existing Program. Given the APLE program already has these strong incentives encouraging individuals to serve as science and math teachers, we recommend the Legislature reject the Governor's new budget bill provisions. These new provisions actually create restrictions—reserving 600 new warrants only for certain UC and CSU students—that could make meeting the program's intent more difficult. Rather than add unneeded complications to an already well-structured program, we recommend allowing the existing program to serve all individuals that meet its high-need subject and school criteria.

Intersegmental Issue Involving CSAC

In the student fees write-up in the intersegmental section of this chapter, we recommend maintaining nonneedy students' share of education costs at their current-year levels (33 percent at UC and 25 percent at CSU). Because the Governor's budget includes various augmentations that drive up per student costs at UC and CSU, holding students' share of cost constant would entail modest fee increases (3.5 percent at UC and 3 percent at CSU). In our fees write-up, we recommend a corresponding increase in Cal Grant award amounts sufficient to ensure that all eligible financially needy students receive grants that fully cover the fee increases. Based on the commission's projections of Cal Grant participation, we estimate the additional coverage would cost $11.9 million ($8.3 million for financially needy students at UC and $3.6 million for financially needy students at CSU).

Restructuring How the State Administers Grant and Loan Financial Aid Programs

Last year, members of the education policy and fiscal committees expressed concern with the organizational relationship between CSAC and EdFund. Responding to a legislative directive, our office released a report in January 2006 that examined this relationship and identified options for restructuring it (*California's Options for Administering the Federal Family*

Education Loan Program). Below, we summarize the organizational options the state has for administering grant and loan financial aid programs. We then identify the shortcomings both of the state's original single state-agency structure and its existing two-agency administrative structure. In the final section, we recommend the state restructure how it administers these financial aid programs.

Organizational Options

As we discuss in more detail in our January 2006 report, the Legislature has five basic options for coordinating administration of state grant programs and federal student loan programs. As summarized in Figure 4, these options can be grouped into single-agency structures and two-agency structures. To simplify the discussion, we describe these options before applying them to California's experience in administering grant and loan programs.

Single-Agency Options. Under a single-agency structure, the Legislature could: (1) entrust a state agency with administering both grant and loan programs or (2) establish a nonprofit public benefit corporation to administer them. Under a state-agency model, the Legislature would give responsibility for grant and loan program administration to CSAC or another state agency. This entity would be subject to all applicable state laws and regulations, including those relating to hiring, compensation, promotion, and procurement. Under this model, the state agency could provide all program services internally or contract for any or all services. Under a nonprofit public benefit corporation model, the primary difference is that the agency would be exempt from state employment and procurement practices, thereby afforded greater autonomy and flexibility in its daily operations.

Two-Agency Options. Under a two-agency structure, the Legislature could: (3) retain the existing two-agency arrangement, (4) modify the existing two-agency arrangement, or (5) rely on a state agency to administer grant programs and an independent agency to administer federal loan programs. Maintaining the status quo obviously is the simplest option in that no statutory changes would be required. The Legislature, however, could modify the existing arrangement by making various statutory changes to clarify the roles and responsibilities of the grant agency vis-à-vis the loan agency. For example, the Legislature likely would want to clarify which agency had responsibility for budget development, resource allocation, policy leadership, and representation before the state and federal governments. Instead of using a loan agency that was an auxiliary of or otherwise dependent on the state, the Legislature could use an independent loan agency—either a reconstituted EdFund or another existing loan agency. This latter option would be more involved in that it would entail selling EdFund's existing loan portfolio and entering into a contractual agreement with some other existing loan agency (either a private corporation or another state's loan agency).

Figure 4

Organizational Options

Single Agency	
State Agency Model Single state agency administers state grant programs and federal loan programs. Agency subject to state employment and procurement laws and regulations.	**Nonprofit Public Benefit Corporation Model** Single nonprofit public benefit corporation administers state grant programs and federal loan programs. Agency exempt from state employment and procurement laws and regulations.
Options as Applied to California:	
(1) California Student Aid Commission (CSAC) (or another state agency) administers both grant and loan programs.	(2) EdFund (or another nonprofit public benefit corporation) administers both grant and loan programs.
Two Agencies	
State/Dependent Guarantor Model A state agency administers state grant programs and a separate state-dependent or auxiliary agency administers federal loan programs. State employment and procurement laws apply to state agency but not loan agency.	**State/Independent Guarantor Model** A state agency administers state grant programs and an independent agency administers federal student loan programs. State employment and procurement laws apply to state agency but not loan agency.
Options as Applied to California:	
(3) Make no changes to existing CSAC/EdFund arrangement. (4) Modify CSAC and EdFund's roles and responsibilities.	(5) Rely on CSAC (or another state agency) to administer state grant programs and an independent agency to administer federal loan programs.

Single State-Agency Structure Had Shortcomings

Of the five organizational options identified above, California relied on a single state-agency structure from 1979 to 1996. During this period, CSAC administered both grant and loan programs. By the mid-1990s, the state Legislature, federal government, and financial aid stakeholders expressed concern with this structure and specifically with CSAC's ability to administer the federal loan programs.

Single State-Agency Model Deemed Too Rigid, Not Adequately Responsive. To understand better the problems that spurred the initial creation of EdFund, we reviewed independent evaluations, state audits, and federal audits conducted in the early- and mid-1990s. We also conducted interviews with individuals familiar with CSAC operations during this period. The problems identified were far reaching—ranging from financial aid processing difficulties and accounting errors to staff inexperience and perceptions among colleges that CSAC was not adequately responsive or service-oriented.

EdFund Designed to Be More Responsive. In 1996, the Legislature authorized CSAC to create an auxiliary agency for the purpose of administering federal student loan programs. As defined in statute, the auxiliary agency is a nonprofit public benefit corporation that is exempt from certain state employment and procurement laws. Individuals involved in developing the 1996 legislation state that these particular statutory provisions were viewed as critical changes designed to allow the auxiliary agency to respond more quickly and effectively to loan market dynamics, colleges, and students.

Existing Two-Agency Structure Has Shortcomings

Since 1996, the state has relied on a two-agency structure—using CSAC to administer state grant programs and EdFund to administer federal loan programs. By 2005, the Legislature, as well as various stakeholders, was expressing growing concern with this two-agency, shared-control structure. We think much of this concern can be linked with three shortcomings of the existing organizational structure. (The Bureau of State Audits is currently reviewing EdFund's employment and procurement practices to determine if other problems exist. The auditor is expected to release its findings in spring 2006. Given the audit is still underway, we do not address these particular issues.)

Separate Governing Bodies Has Led to Tension Among Organizational Leadership. We think one of the major shortcomings of the existing organizational arrangement stems from its competing governing bodies. Figure 5 shows the composition of these governing bodies (as of April 2005). As reflected in the figure, state law specifies that CSAC is to be

TAB 3B

Figure 5

Structure of Governing Bodies

Student Aid Commission (15)
Representatives From:

Governor appoints, Senate confirms (11):

- -UC
- -CSU
- -CCC
- -Independent college
- -Public, proprietary, or nonprofit college
- -Students (2)
- -Secondary school
- -General public (3)

Senate Rules Committee appoints (2):

- -General public (2)

Speaker of the Assembly appoints (2):

- -General public (2)

EdFund Board of Directors (14)[a]
Representatives From:

Commission determines size and composition:

- -UC
- -CSU (3)
- -Independent college in California (2)
- -Public college outside California
- -Students
- -Business (2)
- -Attorney
- -EdFund employee
- -Student Aid Commission Executive Director
- -EdFund president

[a] As of April 1, 2005.

governed by a 15-member commission. The commission is responsible for appointing a board of directors for its auxiliary agency. The commission is given broad authority to determine both the size and composition of this board. Furthermore, EdFund's bylaws permit the commission to remove any individual serving on the board at any time, with or without cause. Despite being given no ultimate, independent authority, EdFund is delegated (both by law and its operating agreement) major operational responsibilities. Ever since the inception of EdFund, this disconnect between organizational authority and operational responsibility has created considerable tension between the two agencies.

This tension was evident in spring 2005 when the commission voted to dismantle the EdFund board. In the minutes from the April 2005 commission meeting, the commission indicated its action was motivated by concerns with governance as well as by a desire to ensure both agencies were working together toward a united set of goals. Many parties (including legislators, financial aid administrators, and lenders) expressed concern that the decision to dismantle the board threatened EdFund's stability and viability.

State Law Lacks Clarity on Which Agency Is Responsible for Which Operational Functions. A second shortcoming of the existing organizational arrangement is the lack of clarity and agreement on which agency should be entrusted with which specific operational responsibilities. Silent on specific operational issues, state law calls for these responsibilities to be negotiated in a jointly developed annual operating agreement approved by the commission. In our discussions with CSAC and EdFund leadership, several areas of concern were raised about the existing ambiguity in law and resulting tension within the negotiation process. Most importantly, concerns revolved around determining who is responsible for developing EdFund's budget, designating the use of Operating Fund monies, representing EdFund's interests to the state Legislature, negotiating EdFund's working agreements with the federal government, and resolving grievances of EdFund's remaining civil service employees. This interagency tension continues to manifest itself in the currently unresolved discussion involving the agencies' roles. After several months of discussion and various draft proposals regarding these responsibilities, the issues remain unresolved.

Incompatible Incentive Systems Detract From a Student Focus. Third, whereas CSAC is structured as a traditional state agency whose employees are subject to civil service laws, EdFund's status as a nonprofit corporation has fostered more market-driven practices. For example, EdFund uses variable compensation plans that offer incentive compensation to reward employees for providing high-quality service in their respective domain. These plans are notably different from the typical civil service compensation plans based on routine step increases. Both CSAC and EdFund leadership expressed concern that these incompatible incentive systems have led to certain perceptions of unfairness among staff and directors. Equally important, the resulting interagency tension has detracted from a public focus on providing students with high-quality grant and loan services.

Recommend Single Agency With Flexibility in Daily Operations but Stronger Accountability Requirements

We recommend the Legislature enact legislation that would restructure how the state administers grant and loan programs. Specifically, we recommend the Legislature authorize a single agency, with a single board and Executive Director, to administer both state grant and federal loan programs. We recommend the agency be structured as a nonprofit public benefit corporation but subject to stronger accountability requirements.

As described in more detail in our January 2006 report, we think any restructuring proposal should overcome both the original shortcomings that led to EdFund's creation and the shortcomings of the existing two-agency structure. In particular, we think an organizational solution should reduce tension among organizational leadership, clarify certain roles and responsibilities, and promote incentives that reward high-quality service to students. Given the unique intricacies of student financial aid and the unique aspects of the federal student loan programs, we think these objectives could best be met with a single nonprofit public benefit agency that has a unified leadership and an incentive system that rewards employees based on the quality of service they provide to students.

This Option Most Likely to Overcome Existing Problems. Compared to a two-agency, shared-control structure, a single-agency structure has certain inherent advantages. With a single agency, board structure, and Executive Director, tension is less likely among organizational leadership, and confusion about roles and responsibilities is likely to be more easily and quickly resolved. Moreover, as a nonprofit public benefit corporation, the agency would have more flexibility in its daily operations. This would allow the agency to adapt more quickly to changes in loan programs and loan competitors—changes that can have significant effects on agencies' market share and the benefits they are able to provide student borrowers. This structure also would allow the agency to reward all employees—in both the loan and grant divisions—for providing high-quality service to students.

Greater Autonomy Should Be Coupled With Greater Accountability. Increasing an agency's autonomy over its daily administrative activities should be coupled with increased attention to accountability. Toward this end, the Legislature could establish accountability requirements to ensure the agency is meeting legislative intent and providing students with excellent service. Specifically, we recommend the Legislature require the agency to submit various budget documents, conduct annual audits, and report on program outcomes. (Additionally, depending on the findings of the pending state audit, the Legislature might want to establish other safeguards or limitations on the agency's operations.) Because the agency would be a statutory creation, the Legislature, as further protection, would retain ultimate authority over it.

New Structure Could Accommodate Broader Reform. We think another distinct advantage of our recommendation is that it creates a structure within which other reforms could easily be accommodated. As a single agency, it would be better situated to integrate grant and loan information and services. As such, the Legislature could consider a variety of other reforms related to financial aid administration. For example, the new agency could assume responsibility for the state's savings and scholarship programs (currently administered by the Scholarshare Investment Board). This would unify all state-level financial aid administration in one umbrella agency and create a one-stop shop for state-level financial aid information.

Conclusion

Over the last several decades, California has experimented with two organizational structures for administering state student grant programs and the federal student loan programs. It has tried both a single state-agency structure and a two-agency, shared-control structure. It has had notable problems with both structures. We recommend the Legislature establish a new structure. Specifically, given the unique intricacies of student financial aid, we recommend the Legislature authorize a single agency with a unified leadership to administer both grant and loan programs. Furthermore, given the unique market-oriented and competitive nature of the federal student loan programs, we recommend the Legislature structure this agency as a nonprofit public benefit corporation that would have greater flexibility over its daily operations, with the ultimate intent of increasing public accountability and providing the best possible services and benefits to students.

TAB 3C

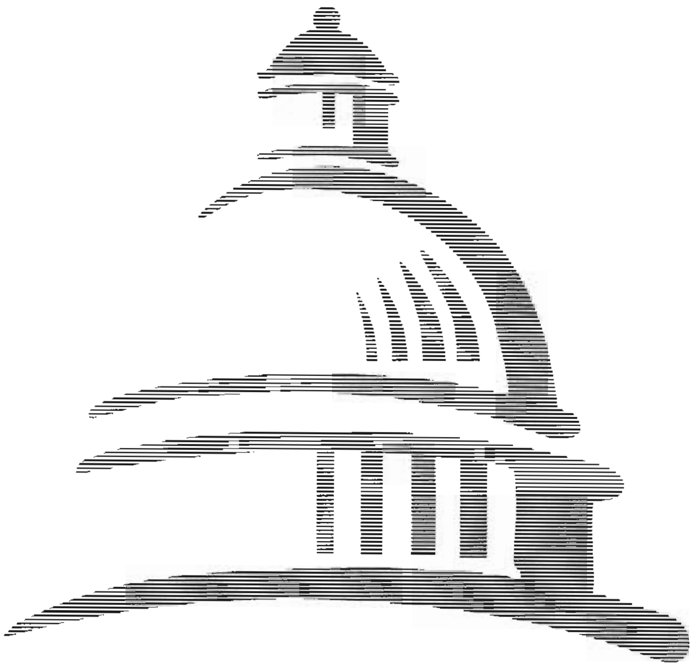
LAO
65 YEARS OF SERVICE

March 8, 2006

Reforming the Governance Structure of the California Student Aid Commission and EdFund

LEGISLATIVE ANALYST'S OFFICE

Presented To:
Joint Assembly and Senate Education Committee



LAO
65 YEARS OF SERVICE

A History of Governance Problems

Initial Problems:

- ☑ In the 1980s and early 1990s, the California Student Aid Commission (CSAC) struggled to administer the federal student loan programs effectively.
- ☑ In response, the Legislature passed Chapter 961, Statutes of 1996 (AB 3133, Firestone), which authorized CSAC to establish an auxiliary agency. The auxiliary agency was entrusted with administering the federal student loan programs on the state's behalf.
- ☑ In 1997, the commission created EdFund as its auxiliary agency.

Recent Problems:

- ☑ Since its inception, EdFund and CSAC have struggled with a new set of governance problems.
- ☑ These governance problems came to the fore last spring when the commission dismantled the EdFund Board of Directors.

Legislative Response:

- ☑ In response to these more recent governance problems, the Legislature directed our office to submit a report identifying the range of structural options for administering the federal student loan programs. We released this report in January.
- ☑ In our February *Analysis*, we have a follow-up piece that recommends specific changes to the existing CSAC/EdFund governance structure.

LAO
65 YEARS OF SERVICE

Other Operational Problems Might Exist But Still Under Investigation

Another Set of Potential Problems:

- ☑ Last spring, the evident governance problems were compounded by allegations that EdFund might have inappropriate compensation and contracting practices.

Legislative Response:

- ☑ In response to these allegations, the Legislature directed the State Auditor to investigate these practices. The audit report is scheduled for release in April 2006.

- ☑ Given the audit is underway and its findings and recommendations have not yet been shared, we do not address these other operational issues.

Possible Impact of Audit Findings:

- ☑ If the state audit finds that EdFund has operational problems, the Legislature could either respond to those issues separately or in the same legislation addressing governance problems.

- ☑ One of the major benefits of the state audit is likely to be the identification and recommendation of stronger accountability provisions that could be critical under any governance structure.

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EdFund Created to Overcome Initial Governance Problems

- ☑ In 1979, CSAC began administering the federal student loan programs.
- ☑ From 1979 to 1996, CSAC served as the single state agency responsible for administering both state grant programs and federal student loan programs.
- ☑ In the early to mid-1990s, concerns with CSAC administration of the federal student loan programs grew.
- ☑ The creation of EdFund essentially was the state's attempt to overcome existing governance problems and improve the efficiency and effectiveness of the state's administration of the federal student loan programs.
- ☑ Statute designated the auxiliary agency as a nonprofit public benefit corporation, and, as such, the agency was exempt from certain state employment and procurement practices.
- ☑ The new governance structure and associated statutory provisions were viewed by lawmakers and legislative staff as critical changes needed to enhance the state's responsiveness to loan market dynamics, colleges, and students.

LAO
65 YEARS OF SERVICE

Governance Problem 1: Tension Among Organizational Leadership

Separate Governing Bodies Have Created Tension Among Organizational Leadership.

- ☑ The commission consists of 15 representatives appointed by the Governor and Legislature that reflect the interests of higher education institutions, students, secondary schools, and the general public.

- ☑ The commission determines the size and composition of the EdFund Board of Directors.
  - As of April 1, 2005, the EdFund board had 14 representatives reflecting the interests of higher education institutions, students, business, law, EdFund employees, the CSAC Executive Director, and EdFund president.

- ☑ EdFund's bylaws permit the commission to remove any individual serving on the EdFund board at any time, with or without cause.

- ☑ When the commission voted to dismantle the EdFund board last spring, the minutes from the commission meeting indicated that the action was motivated by concerns with governance as well as by a desire to ensure that both agencies were working together toward a united set of goals.

- ☑ A disconnect continues to exist between organizational authority and operational responsibility.

LAO
65 YEARS OF SERVICE

Governance Problem 2: Disagreement Over Roles and Responsibility

State Law Does Not Adequately Delineate Which Agency Is Responsible for Which Operational Functions.

☑ In our interviews with the two agencies, several areas of ambiguity and tension were identified, including determining which agency is responsible for:

- Developing EdFund's budget.
- Designating the use of Operating Fund monies.
- Representing EdFund's interests to the state.
- Negotiating EdFund's performance contacts with the federal government.

☑ This tension is vividly illustrated by the inability of the two agencies to agree on any of the various draft proposals regarding their respective roles and responsibilities.

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Governance Problem 3: Incompatible Incentive Systems

Incompatible Incentive Systems Have Detracted From a Student Focus

- ☑ Whereas CSAC is structured as a traditional state agency whose employees are subject to civil service laws and regulations, EdFund is structured as a nonprofit corporation whose employees are exempt from these laws and regulations.

- ☑ Whereas CSAC has typical civil service compensation plans based on routine step increases, EdFund uses variable incentive compensation plans that reward employees for providing high-quality service in their respective area.

- ☑ The leadership of both agencies has expressed concern that these incompatible incentive systems have led to certain perceptions of unfairness among staff.

- ☑ The resulting interagency tension also has detracted from a public focus on providing high-quality loan and grant service to students.

LAO
65 YEARS OF SERVICE

Range of Restructuring Options

☑ The Legislative could select one of five basic organizational models for administering state grant and federal student loan programs.

Organizational Options

Single Agency	
State Agency Model Single state agency administers state grant programs and federal loan programs. Agency subject to state employment and procurement laws and regulations.	**Nonprofit Public Benefit Corporation Model** Single nonprofit public benefit corporation administers state grant programs and federal loan programs. Agency exempt from state employment and procurement laws and regulations.
Options as Applied to California:	
(1) California Student Aid Commission (CSAC) (or another state agency) administers both grant and loan programs.	(2) EdFund (or another nonprofit public benefit corporation) administers both grant and loan programs.
Two Agencies	
State/Dependent Guarantor Model A state agency administers state grant programs and a separate state-dependent or auxiliary agency administers federal loan programs. State employment and procurement laws apply to state agency but not loan agency.	**State/Independent Guarantor Model** A state agency administers state grant programs and an independent agency administers federal student loan programs. State employment and procurement laws apply to state agency but not loan agency.
Options as Applied to California:	
(3) Make no changes to existing CSAC/EdFund arrangement. (4) Modify CSAC and EdFund's roles and responsibilities.	(5) Rely on CSAC (or another state agency) to administer state grant programs and an independent agency to administer federal loan programs.

LAO
65 YEARS OF SERVICE

LAO Restructuring Recommendation

☑ Given the unique intricacies of student financial aid, we recommend the Legislature authorize a single agency, with a single board and Executive Director, to administer both state grant and federal loan programs.

☑ Given the unique aspects of the federal student loan programs, we recommend the agency be structured as a nonprofit public benefit corporation but subject to stronger accountability requirements.

☑ This option is most likely to overcome existing governance problems.

- With a single board and Executive Director, tension is less likely among organizational leadership.
- With a single agency, confusion about roles and responsibilities is likely to be more easily and quickly resolved.
- As a nonprofit public benefit corporation:
  - The agency could reward all employees for providing high-quality service to students.
  - The agency would retain flexibility to respond to externally driven changes in loan programs and loan competitors.

☑ Greater operational autonomy should be coupled with greater accountability and reporting requirements.

☑ The new structure could accommodate broader reform.

Informational Hearing of March 8, 2006
Senate Education Committee
Senate Budget and Fiscal Review Subcommittee No. 1 on Education
Assembly Higher Education Committee

Senator Jack Scott and Assemblymember Carol Liu, co-chairs

Examining the Governance of EDFUND and the Student Aid Commission - Options for the Federal Family Education Loan Program

TESTIMONY OF SAM KIPP, EDFUND PRESIDENT

Good morning members of the Senate and Assembly committees. I am Sam Kipp, President of EDFUND. I am pleased to be here today. I want devote a couple of minutes to describe EDFUND and then cover some of the current issues we are facing.

EDFUND was created in 1997 as a nonprofit public benefit corporation and an auxiliary, or subsidiary, corporation of the California Student Aid Commission. EDFUND was created because the state and the Commission had determined that it was not possible to provide competitive, responsive, high quality student loan services within a state agency structure. We all knew that something dramatically different needed to be done. EDFUND was given the authority at first to provide the Commission's student loan guaranty agency services. In later legislation, you gave EDFUND the added authority to deliver other services that are related to the mission of the Student Aid Commission.

EDFUND has met, and it has exceeded, the mandate set by the California Legislature and the Student Aid Commission when we were created.

- We earned more than $995 million in revenue
- We spent $613 million on operations, reducing annual costs by $7 million
- We generated net income of more than $380 million
- We contributed $286 million toward state of California expenses
- We collected $3 billion in unpaid defaulted loans
- We tripled annual loan volume, from $2.4 billion to $7.8 billion
- We eliminated federal audit findings and resolved the outstanding ones
- We saved borrowers more than $300 million in fees
- We reduced the default rate from 14.4% to 6.4%

We believe that we have made real improvements in how students receive their loans, and in the support we provide to the colleges, universities, and vocational schools they attend. These changes include putting expert staff out in the field to work closely with schools to improve services, building advanced loan processing technology, supporting award-winning borrower communications, and developing on-line tools to help borrowers to obtain their loans and to manage their debt. We measure the satisfaction of borrowers, schools, and lenders, and our own employees, each year and fine-tune our programs and services to meet their expectations. Our work every day is built around being a mission-driven, values-based, and customer-focused nonprofit organization.

We also face challenges:

- Under new federal laws, we are compelled to charge borrowers a 1 percent loan fee for the first time since 1996. This action will begin October 1, 2006. We're proud to have been able to save borrowers over $300 million in fees, but also disappointed that we can't continue the fee waiver for at least another year, as some of our competitors will do.

- The new federal law also cuts the income earned from defaulted student loan collections – our largest single source of revenue – and compels us to alter our collection strategies and methods rapidly.

- We are still in the process of negotiating a new voluntary flexible agreement (VFA) with the US Department of Education. This agreement will allow us to earn performance-based income for preventing student loan defaults, and it will be highly beneficial, but the process of obtaining agreement on a new VFA has taken longer than we would have desired.

- We are currently in the process of reducing costs to meet the new lower federal income streams, a process that is not easy because we are already a fairly lean and efficient organization. For example, we have already tripled the amount of new loan volume processed, but because of built-in efficiencies, new technology, and process improvements, we've increased our costs by only 7 percent since 1998.

- Finally, the state is still using loan program revenues to pay for $22 million in Student Aid Commission administrative costs and support the Cal-SOAP program. This can simply no longer be sustained.

The relationship between the Student Aid Commission and EDFUND has generally worked well and has delivered real benefits to the citizens of California, and to students and educational institutions throughout the nation. But it is also a relationship that has admittedly featured periodic tension between the two organizations.

The Legislative Analyst covered this issue effectively and raised two very important questions: how best to provide federal student loan guaranty agency services on a national scale through EDFUND and how to operate the Commission's state financial aid services.

We have not adopted a position on the Analyst's recommendation to operate both organizations through a single nonprofit, public benefit corporation. Yet, as you examine the Analyst's recommendation, I would like to identify several key issues:

First, it will be critical to sustain and not disrupt or diminish EDFUND'S capacity to continue to provide essential loan funds and premier services to borrowers and institutions. You may hear from lobbyists for out-of-state, for-profit companies that they could do as well or better, but our school customers and lender partners know better. These are the same companies that have been losing market share ever since EDFUND was created because ultimately schools decide who their students' guarantor will be.

Second, recognize that a nonprofit corporation that provides financial aid services such as technology, accounting, administrative, and customer service is different from one that oversees policy. Indeed, creating a single nonprofit financial aid services corporation may require you to look carefully at where responsibility for state financial aid policy should be housed.

Third, in weighing options, reducing costs and complexity without compromising service will be important considerations.

Fourth, no student loan guarantee services organization can remain competitive in California or nationally without having vital operating flexibility and an adaptive and responsive structure that enables it to provide high quality services.

Fifth, accountability mechanisms are certainly appropriate but they should seek to avoid adding a whole new layer of state agency rules and requirements that do not apply to our competitors.

In closing, we are attuned to our responsibility and accountability, and we are a very open and adaptable, mission-driven organization. We are prepared to work cooperatively and jointly with you as you examine these important issues. Thank you again for inviting me to testify and I would be happy to respond to any and all questions that you may have about EDFUND.

EdFund Facts

ORGANIZATIONAL STRUCTURE: Nonprofit public benefit corporation organized as an auxiliary (supporting) corporation of the California Student Aid Commission

BOARD OF DIRECTORS: 13 members appointed by the California Student Aid Commission

FUNDING SOURCE: Fees from federal government and retention of income from loan collections, all held in the Student Loan Operating Fund

NUMBER OF EMPLOYEES: 642

Key Performance Measures

	Federal Fiscal Year 1998-99	Federal Fiscal Year 2004-05
Revenues	$95 million	$124 million
Loan Volume	$2.4 Billion	$7.8 Billion
Default Rate	7.3%	6.4% (at end of 2004)
Defaulted Loan Collections	$281 Million	$387 Million

	In the nine years *prior to* EdFund	In the nine years *since* EdFund was established
Loan Volume	$13 Billion	$39 Billion
Default Rate (ending rate)	14.4% (at end of 1996)	6.4% (at end of 2004)
Defaulted Loan Collections	$775 Million	$2.984 Billion

EdFund and Loan Program Revenues and Expenses (in Millions) by Federal Fiscal Year

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	Cumulative Total	Change from 1998-2005
EdFund/Loan Program Revenues	$94.7	$101.0	$129.0	$169.6	$225.5	$151.7	$123.5	$995.0	+30%
EdFund Operating Expenses	$81.5	$93.0	$94.5	$88.2	$86.0	$82.5	$87.5	$613.1	+7%
Operating Surplus before Other Expenses	$13.2	$8.0	$34.5	$81.4	$139.5	$69.2	$36.0	$381.9	+172%
State Program Expenses	$1.9	$1.8	$1.8	$2.2	$16.7	$180.5	$81.1	$286.1	+4168%

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March 8, 2006

Assembly Higher Education Committee &
Senate Education Committee
Talking Points

March 8, 2006 Informational Hearing
Options for the Future of EDFUND
James Sandoval, Chair
California Student Aid Commission

My name is James Sandoval, and I am the Chair of the California Student Aid Commission. I appreciate the opportunity to address the members of the committees this morning and I look forward to working with you as the Legislature explores options for the future of the Commission and EDFUND. We pledge our full cooperation and assistance as the Governor and Legislature review options for administering the Federal Family Education Loan Program.

The Commission's mission is *to make education beyond high school financially accessible to all Californians.* As you know, we administer statewide financial aid grant programs – primarily the $800 million Cal Grant Program, and we are also the state's designated guaranty agency for the Federal Family Education Loan Program. To fulfill our responsibilities under the federal student loan programs, EDFUND processes $7.8 billion a year in new federal student loans of which approximately 53 percent goes to students attending colleges and universities outside of California. In total, EDFUND administers an outstanding loan portfolio worth more than $26 billion. No state General Funds are used to administer the federal student loan programs; in fact, revenues from the loan program are used to support the Commission's Cal Grant administration and finance the state's Cal-SOAP (California Student Opportunity and Access) Program.

Nine years ago, the state authorized the Commission to create an auxiliary nonprofit corporation to administer its services as a federally designated student loan guaranty agency. That nonprofit corporation – EDFUND – has achieved remarkable success working with the Commission in improving the level of service provided to student loan borrowers and colleges and universities, expanding public service programs that benefit borrowers, and earning surplus income that has been used to support more than $280 million for the state of California, including $197 million in Cal Grants. However, we agree that even with the level of success, managing the complex relationships and interactions between a state agency and a nonprofit corporation that must be able to compete in the student loan marketplace nationwide, have been challenging.

The Commission continues to work to more effectively define its role in relation to EDFUND as an auxiliary organization. We agree with the Legislative Analyst that structural changes for the Commission and EDFUND are needed. While the Commission has not taken a position on the LAO's recommendation to create a single non-profit agency to administer the grant and loan programs, we concur that the Legislature should review the mission, structure and governance of both CSAC and

EDFUND so that both organizations are positioned to efficiently and effectively deliver the State's financial aid programs and the federal student loan program.

The LAO recommendation also includes the new and far-reaching option of transferring the Commission's remaining financial aid operations into a nonprofit corporation structure. We frankly have not had the time to fully evaluate this option and develop positions and recommendations, but we look forward to actively engaging in discussions with you as various alternatives are developed, discussed and considered.

At its February meeting, the Commission also committed to discussing these issues openly and publicly with the full range of CSAC and EDFUND stakeholders including, but not limited to, the Commission's Grant Advisory Committee and the Loan Advisory Committee.

In considering any options to restructure the Commission and EDFUND, it is important to note that legal, operational and policy issues will need to be examined. These include, but are not limited to, the following:

- How can the transition to a new governance and organizational structure be managed so as to not disrupt the delivery of grants and loans, not diminish services to students and institutions, and not compromise EDFUND's competitive position?
- Who should have responsibility for policy with respect to the Cal Grant programs and with respect to the federal student loan programs?
- How should the Board of a single agency, which serves students in California and throughout the nation, be structured? What should be its composition?
- What are the most appropriate mechanisms to preserve the administrative flexibility and competitiveness of the non-profit public benefit organization while ensuring accountability?
- How can the awarding, delivery, and administration of Cal Grants be best structured to insure quality service to students and institutions, efficiency, program effectiveness, and accountability?
- How could current state employees be integrated into the workforce of a non-profit, public benefit corporation while protecting their jobs, benefits, and retirement rights?
- Are there efficiencies that could be achieved through the creation of a single non-profit public benefit corporation? If so what are they and how much could potentially be saved?

These are only a few of the issues that will need to be considered as you examine the recommendations of the Legislative Analyst and your future options for administering student financial aid programs in California.

In closing, I once again thank you for the opportunity to appear before this joint committee hearing this morning. The Commissioners commit to working with you and your staff to ensure that together we develop positive solutions and a business model that will continue to serve students by removing the financial barriers that can prevent access to their achievement of a higher education.

Governance of EdFund and the California Student Aid Commission:
Options for the Federal Family Education Loan Program

Joint Hearing of the Assembly Committee on Higher Education and the Senate Education Committee

March 8, 2006

Testimony of Greg Gollihur, Senior Policy Analyst
California Postsecondary Education Commission (CPEC)

Chairman Scott, Chairwoman Liu, members of the Senate Education Committee and the Assembly Higher Education Committee, I am Greg Gollihur with the Postsecondary Education Commission and I am pleased to provide comments on the recommendations of the Legislative Analyst's Office for restructuring CSAC/EdFund governance and operations. Although CPEC has taken positions with regard to the Cal Grant programs my remarks and observations are, for the most part, my own and come as the result of over 23 years experience in the management, policies and operations of student loan and grant agencies. During that time I have had the opportunity to work in both public and private agency structures and have provided consulting services to state based agencies seeking to optimize delivery of both grant and loan aid to schools, students and families.

First, the Analyst's recommendation to create a single not-for-profit entity responsible for the delivery of the Cal Grant programs as well as the Federal Family Education Loan Program is solid, sensible, and doable. The existing arrangement is unworkable and it is not in the interest of students, schools, or the organizations themselves to allow it to continue. A great deal of damage has been done to EdFund's standing in a highly competitive, national market place. These distractions have also served to divert attention from real problems in the grant delivery system that, unlike the Federal Family Education Loan program, really *are* the responsibility of the State.

The issues accurately identified by the Analyst at the heart of the controversy include:

- Responsibility for the development of EdFund's Budget
- The use of Student Loan Operating Funds
- Negotiating responsibility for a Variable Flexible Agreement with the Federal Department of Education
- Representation of EdFund's interest before legislative and regulatory bodies, and;
- Differences in the agencies incentive and compensation practices

These issues are, as the Analyst points out, the direct result of a "fundamental disconnect between operational responsibility and organizational authority" between the two organizations. The structure recommended by the Analyst would, for the most part, alleviate problems and point the organization in a new, more positive direction.

Beyond resolving the governance issues that have plagued the organizations and created confusion and uncertainty in the financial aid community, there are a number of real advantages for students, schools and the State from the proposed model.

- **Consolidation of duplicative and overlapping functions** such as outreach, customer service call centers, IT, governmental representation and particularly the current "oversight" of EdFund by CSAC could result in substantial savings. There also exists an opportunity to duplicate EdFund's success in delivering loan services in the grant programs. This success has come primarily through its attention to technological investment and customer service.

- **Performance-based delivery systems.** - The delivery of over $800 million in Cal Grant aid is an administrative and operational challenge of the first order. It impacts student choice and is critical to the viability of both private and public institutions of higher education in California. The difficulty of the current state agency structure in meeting the needs of students and schools argues for the establishment of a "performance-based" organization. At the federal level, the creation of a "performance based organization" or PBO within the Department of Education is a successful model worth emulating. It has resulted in a series of clean audits and the removal of the student loan programs from the General Accounting Office's list of high-risk federal programs.

There are also a number of issues that should be examined when considering the approach recommended by the Analyst:

- **Clearly define the role of the Student Loan Operating fund**. The purpose in creating EdFund was to allow it to operate in a business like manner and remain competitive with other national guarantors. The Analyst, in its initial report, suggests the necessity of a clear revenue sharing expectation for the Student Loan Operating Fund. I would further suggest that without an explicit delineation of the fund's responsibilities, EdFund will continued to be disadvantaged in the market place. No business can operate effectively without knowing its own capital base. The state should reexamine the practice of using Operating Fund reserves to subsidize general fund responsibilities -- particularly in the aftermath of the most recent reauthorization of the Higher Education Act. The first priority of the Operating Fund should be the delivery of high quality services and benefits to the schools and students using the EdFund guaranty.

- **The Guaranty function** should also be made the responsibility of the not-for-profit entity. The current arrangement, whereby CSAC retains the guaranty while EdFund is responsible for administration of the loan programs has contributed to the current state of confusion over roles and responsibilities. Please remember that the state has no liability for the federal loan programs and there is no reason that the guaranty should remain in it' name.

- **The importance of business diversification** - If EdFund can effectively compete in the delivery of student loan related serves, it should be allowed to do so. Schools, students and families would benefit, and the State's interest in maintaining a viable business entity, capable of supporting other activities such as outreach and the administration of the Cal Grant programs, would be enhanced. The Analyst points to Kentucky and Pennsylvania as examples of not-for-profit entities that administer both grant and loan programs. In both these instances the organizations have extensive loan related business, including origination, servicing and secondary market enterprises that support, subsidize and help provide excellent service to their customers.

- **Reengineer the grant programs along a decentralized model** - CPEC has recommended, and continues to recommend, that the grant programs be administered primarily at the campus level. In fact this may be a model driven by necessity. If EdFund and the Student Loan Operating Fund are asked to continue to support the operations of the Grant programs under a new structure, they will need to do so in the most cost-effective, efficient manner possible. The current model does not fit that bill.

- **Provide for greater Community Input** – For a variety of reasons, the Student Aid Commission's two primary sources of community input - The Grant Advisory Committee and the Loan Advisory Council - have not been effective. These entities, or their equivalent, should play a much more active role and should be a real resource for policy and budget decisions.

- **Policy versus Operations** – As the possible realignment of CSAC/EdFund is examinded, you may want to give some consideration to separating out the policy development functions from a not-for-profit operational entity. Although this is not absolutly necessary it would help ensure that the focus of the new entity is on the dilivery of services. The protracted policy debates over such issues as eligibility criteria, segmental share of grant program funding, or the relationship of Cal Grants to student fees could, and perhaps should, take place in another venue altogether.

Thank you for this opportunity provide my perspective on the Analyst's recommendation. I would be happy to answer any questions you may have.

Joint Hearing of the Senate Education Committee and the Assembly Higher Education Committee
Testimony for Catherine Thomas, University of Southern California and representing the Association of Independent California Colleges and Universities (AICCU)

Chairs Scott and Liu and Education Committee Members, I am Catherine Thomas, Associate Dean of Admission and Financial Aid for the University of Southern California. I direct the university's financial aid programs. While my primary responsibilities are to assure that USC students receive all the financial aid for which they are eligible, I also work on the broader financial aid policy questions of student access and equity. Being a member of the CSAC Grant Advisory Committee since 1991 has allowed me to work on these issues at the state level.

The State of California has provided guarantee services for federally funded student loans since 1987. Between then and the middle 1990s, the Commission experienced major problems with the administration of the loan program while operating as a state agency. After a thorough review, the state created an auxiliary organization called EdFund, a non-profit subsidiary of the California Student Aid Commission. Ed Fund was fortunate to find a talented executive named Becky Stilling. Under her leadership the company grew from a struggling start-up to the second largest guarantor in the country. More important than its loan growth, EdFund has offered students and institutions a total of more than $500 million in benefits including reduced costs for students and useful services to prospective students and institutions. It reduced administrative costs by 11% and lowered the default rate for California students by almost a third - a remarkable record by any account. Ms. Stilling was one of the most talented administrators with whom I have ever worked. However, as pointed out in the Legislative Analyst's report, the current organizational structure has caused conflicts and impaired the ability of EdFund to make continued progress. The departure of Ms. Stilling and several key members of the management team as well as the uncertainty surrounding the governing board remain of great concern to institutions. Those unexpected changes leave the higher education community feeling that EdFund's successes and ability to deliver quality service are at risk.
These same concerns exist in states other than California that benefit from EdFund services. We are very fortunate to have Dr. Samuel Kipp step in to fill the void left by the turnover in executive management. Yet troubling vulnerabilities remain.

The University of Southern California provides federal Stafford and PLUS loans to our students and their families totaling over $220 million in the 2004-2005 academic year. EdFund provided the guarantees for about $187 million of those loans. That is 85% of our total federal loan volume. Next year, we expect the California figure to increase as much as $45 million as students take advantage of the new Graduate PLUS Loan. Because of USC's high volume of loans and cohort default rates under 1%, many guarantors come courting. We have never seriously entertained using any other primary guarantor. First and foremost we value EdFund's commitment to service. Since its creation Ed Fund has not only been concerned about creating loan volume but also about helping students avoid loan defaults. Ed Fund established a position of national leadership with attention to service. Second, the University feels a commitment to support well run programs in California that serve the public interest. However, the tensions of the last year between the Commission and EdFund and the uncertainty in governance and structure have given us pause. While we are not ready to leave this important relationship, there is no doubt that these problems have shaken our confidence. Ultimately, USC will choose an organization that can provide quality services for our students and our university at the lowest cost to students. We are also concerned about the reinstitution of the 1% guarantee after September 30, 2006. That will cost USC and other California students a significant amount of money We understand the complex reasons why this is necessary, but we feel that the lack of clear definitions in the CSAC/EdFund relationship have been part of the problem.

The LAO report is an excellent starting point to consider what should be done next. The state tried to operate a grant and loan program completely as a state agency and discovered that, in the competitive markets for student loans, the state agency model did not serve student or institutional needs well. For the last seven years we have seen a mixed model with both very good and very bad results. While the loan company grew, the conflicts between the state agency and the more entrepreneurial loan entity became unmanageable.

What USC and the rest of the independent sector hope the legislature will do over the next several months is to take the necessary time to examine any and all alternatives that would reinforce the core values and services that have become the EdFund hallmarks. The organizational structure must be one that will serve the needs of students and institutions and yet prevent the dangers and vulnerabilities presented by a full state agency or by the mixed model. We are anxious to see serious attention paid to the grant side of the Commission as well as the loan side. The LAO alternative, which proposes to move all student aid functions to a single non-profit entity, deserves serious consideration. But it also presents some issues that need to be better understood. Whatever the legislative leadership decides, the resulting organization must be efficient in its operations, responsive both to student and institutional needs, committed to a service oriented culture, and always accountable. Those are the core values that made EdFund successful. Our students deserve no less.

I and my AICCU colleagues stand ready and willing to help in your deliberations in any way that we can.

Thank you for your time. I would be happy to answer any questions you might have for me.
Respectfully submitted,

Catherine C. Thomas

March 8, 2006

TAB 3C

California Community Colleges
Student Financial Aid Administrators Association

www.cccsfaaa.org

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HIGHER EDUCATION LEGISLATIVE HEARING ON CSAC AND EDFUND AND THE LAO RECOMMENDATION

March 8, 2006

I am pleased to be testifying today. My name is Craig Yamamoto, and I am representing the California Community Colleges Student Financial Aid Administrators Association (CCCSFAAA), which represents all 109 community colleges in California. Our association is founded on three fundamental principles:

first, accessibility to higher education is essential to the development of human potential and the human condition, and financial aid is an essential access vehicle to higher education;

second, that the effective administration of financial aid programs require accurate, current and focused information on federal and state legislation and regulations governing student financial aid programs;

and third, communication between members of the profession, government agencies, and private and community organizations is critical to the development of effective financial aid programs and the advancement of the profession.

The California Community College segment is the largest system of higher education in the world, serving about 2.5 million students. We serve as the gateway to higher education and play a vital role in ensuring that California has an educated, working population able to contribute to its economic strength and participate in its governance process. The Cal Grant program is a major example of the legislature's investment in access to higher education and is an important financial aid resource for our students. Our segment disbursed 65,267 Cal Grant awards for a total of $74,972,697.00 in the 2004-05 academic year. Each year nearly 45% of all new Cal Grant awards are offered to community college students. While we applaud the opportunity provided to students through the state's grant and loan programs, we believe that the existing organization of the California Student Aid Commission and its subsidiary, EdFund, impedes efforts to expand programs and increase access to higher education.

CCCSFAAA endorses the concept of the Legislative Analyst Office recommendation to enact legislation to restructure the California Student Aid Commission and EdFund into a single agency, with a single board and one Executive Director, to administer both state grant and federal loan programs. We agree with the proposal that the agency be structured as a nonprofit public benefit corporation but subject to stronger accountability requirements.

We believe the single agency structure as a nonprofit public benefit corporation will improve issues that have hindered the two agencies: tension among organizational leadership, confusion over roles and responsibilities, inability of the state grant program to be responsive to school concerns in delivering Cal Grants to students.

However, while we think the single agency structure is beneficial, we are greatly concerned regarding the governing board and the executive director, and reserve our total endorsement of the plan until more information is available concerning the procedures for selecting the governing board and executive director. We strongly recommend involving representatives from all stakeholder constituencies in planning process and decision-making process of any reorganization of the California Student Aid Commission (CSAC).

In our view, one of the problems with the current structure is the delays that occur in the appointment process and the resulting lack of segmental representation. There are currently several unfilled vacancies on the California Student Aid Commission board, including that of the community college representative. Consequently, not all of the five segments of higher education are equally represented in the Commission's discussions and decisions.

In the new single agency structure, EdFund must be allowed to continue business as usual. EdFund has been and continues to be an excellent agency that provides exceptional service to schools and our students. EdFund's focus on students and responsiveness to schools is unprecedented.

Another issue concerning us is the transfer of revenues from EdFund's Student Loan Operating Fund to support California Student Aid Commission programs and Cal Grants. While we recognize the Student Loan Operating Fund is an asset of the State of California, we question the wisdom of drawing from the Student Loan Operating Fund to fund CSAC programs, when the primary purpose of the fund is to be used on EdFund's operations.

We applaud your efforts to address the current California Student Aid Commission organizational problems and look forward to a resolution that will improve the management of the Cal Grant Program, provide EdFund the ability to grow in a competitive marketplace and foster greater collaboration between the Commission and the colleges it serves.

Thank you for giving us the opportunity to provide testimony today. I want to leave you with our CCCSFAAA brochure which explains more about the association, and invite you to contact us as we are more than willing to assist the legislature as they move forward to implement any changes in the governing structure of California Student Aid Commission and EdFund.

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TESTIMONY OF TODD EICHER, EXECUTIVE OFFICER OF NELNET
JOINT HEARING OF THE
CALIFORNIA STATE ASSEMBLY HIGHER EDUCATION COMMITTEE
& CALIFORNIA STATE SENATE EDUCATION COMMITTEE
MARCH 8, 2006

My name is Todd Eicher, and I am here today representing Nelnet, a national education services company which makes, holds, and services student loans, as well as providing a variety of education services to schools, students, and guaranty agencies. I want to thank the committee chairs, Assemblywoman Liu and Senator Scott, and vice chairs, Assemblyman Leslie and Senator Maldonado, for inviting Nelnet to participate in today's hearing.

Nelnet is actively involved in the California student loan market as a lender using the guarantee and services of the California Student Aid Commission and EDFUND. Currently we hold $1,968,967,395 in loans guaranteed by CSAC and originated approximately $695,000,000 in loans to California students in 2005. This figure includes loans originated through CHELA, formerly the California Higher Education Loan Authority, which sold its assets and brand name to Nelnet last year. We also have a partnership with the Hispanic Association of Colleges & Universities (**HACU**), through which we assist in providing student loan-related services to Latino families. Nelnet and HACU have partnered to create the HACU Education Loan Program or HELP Loan. This is a discounted loan that is geared specifically to students attending Hispanic Serving Institutions across the country, especially in California. The partnership has also created scholarships and outreach services for Hispanics in higher education. The next partnership initiative will involve outreach to school districts that serve high enrollments of Hispanic students.

We believe that Nelnet's vision of "Making Educational Dreams Possible" is closely aligned with the interests of these committees. The subject of this hearing is an important one for the students of California and their families. While students don't choose a guarantor for their loans, the services provided to students by their guaranty agency, in conjunction with their school and lender, add significant value in terms of the students' ability to achieve their educational dreams and successfully repay their student loans. This hearing signals that the Legislature recognizes that there may be opportunities to improve the delivery of guaranty agency services to students, their families, and schools in California and beyond.

As a national lender, Nelnet works with 28 of the 35 guaranty agencies. Whether organized as state agencies or nonprofit corporations, successful guaranty agencies share several characteristics. I would urge you to consider how best to incorporate those characteristics as you consider options for the future of the California Student Aid Commission and EDFUND. These shared traits include the following:

Student-Focused Culture – Successful guarantors are dedicated first and foremost to students and their families. They are free from structural, financial, and political pressures which detract from their core focus on delivering services to students.

Adaptability – Successful guarantors are able to adapt to rapidly changing conditions such as we have seen in recent years, including the fierce competition for guarantee volume, as well as the business model changes which have dramatically reduced the federal fee revenue available to guarantors. Agencies that fail to adapt to these changes will not survive.

Innovative Products and Services – Successful guarantors are able to bring to the market a suite of products and services that enhance the entire experience for students, lenders, and schools. This requires that an agency have control over decision-making and access to financial and human resources.

Efficient, State-of-the-Art Systems – Successful guarantors have the resources and ability to conduct their operations on up-to-date systems. A guaranty agency's success is highly dependent on its technology resources. Achieving economies of scale is critical for a guarantor to survive in the current program – but, the maintenance of aging legacy systems diverts significant resources from student benefits. The dilemma faced by many guaranty agencies is that developing new systems is a costly and time-consuming venture. The new guarantor business model does not provide sufficient cash to undertake major new projects. Successful guaranty agencies must either have adequate reserves, a diversified revenue stream, or the ability to partner with others.

Financial Strength and Predictability of Resources – Successful guarantors have sufficient financial resources. The business model changes implemented in 1998 challenged the guarantor community to adapt. Those who have done so have emerged financially strong; others are today on the brink of being unable to meet their federal obligations. Even the healthier agencies have seen their reserves significantly reduced and their future revenue threatened because of the intense competitive pressure to waive the guarantee fee. A number of agencies, including CSAC, have dipped into their operating funds in an effort to outlast competitors in offering this benefit to borrowers. This strategy is not sustainable over the long term for virtually all guarantors.

In many states, including California, state guaranty agencies have faced an additional financial burden -- being required to contribute funds to offset what had previously been state general fund obligations. While it is an understandable action in the current state budget environment, and even desirable when the agency has excess funds, failure to consider the long-term effect of these actions on the agency's market competitiveness could lead to disastrous results. An agency drained of its financial reserves will lack the ability to invest in the innovative products, services, and state-of-the-art technology systems necessary to compete.

Organizational Flexibility – Successful guarantors are able to react nimbly to the demands of the marketplace. States have a vital role to play in deciding matters of financial aid policy; however, it is important to distinguish clearly between policy matters and the day-to-day management of guarantor operations. Successful guarantors are responsible and accountable entities that nonetheless retain the operational flexibility required to manage their business effectively in a competitive environment.

We have observed through our extensive experience partnering with guaranty agencies across the nation that it is essential for any guaranty agency's survival that it continuously adapt to the ever-changing marketplace. Improving the governance model may solve immediate organizational issues in the case of CSAC/EDFUND, but does not address the more fundamental question of the organization's ability to adapt to the dramatically changed guarantor business model and continue to provide exceptional service to the students and schools.

We encourage the committees to consider the characteristics of successful guaranty agencies nationally, and examine the steps taken by others to create a sustainable business strategy. These best practices may offer a roadmap for California. They include:

- Diversification of product and service offerings to enhance the student experience and ensure sustained competitiveness through multiple revenue sources.
- Partnerships or strategic alliances with other companies to achieve diversification's results without heavy capital investment.
- Joint system development or system timesharing with other guarantors to achieve economies of scale and access to state-of-the-art systems at an affordable cost.
- Creative and constructive ways to both increase the level of service provided to students and schools, and lower operating costs. An example of this for California would be streamlining systems such as combining the delivery of both loans and grants through one system or delivery mechanism.
- Outsourcing of some or all operational areas to partners who can provide these services at a lower cost and higher quality due to the efficiencies of economies of scale. Pricing can be done on either a fee-for-service or revenue-sharing basis.

As you consider the future of CSAC/EDFUND, and what is best for the State of California and its students, it should be clear that the single worst option before you is to do nothing. The public struggles between CSAC and EDFUND have already caused a significant loss in value to the state's guaranty agency enterprise. Nelnet's hope is that the guarantor best practices and characteristics of success outlined in my testimony today will offer a framework for action that will assist in Making Educational Dreams Possible for the students and families of California, and return tangible value to the state and its citizens in the future. Thank you once again for your time and the opportunity to provide this testimony to the committees.

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